Emerging Markets Strategy

QUARTERLY COMMENTARY | JUNE 2021

Our global listed infrastructure strategy performed within the range of infrastructure indices, which underperformed global equities for the month.

Economic activity continues to rebound strongly with expected upgrades to consensus earnings and economic growth forecasts.

COVID-19 vaccine rollouts gained pace in many regions, although mobility restrictions remained significant as a result of the new Delta variant. With the combined effect of new restrictions and the continuation of vaccinations, the rate of confirmed cases globally has started to decrease.

Government policy remained supportive, with continued implementation of previously announced stimulus. Bond rates declined slightly in June, post the June FOMC meeting as the Fed continues with the view that the recent inflation spike is largely transitory, with upside risk able to be addressed through potential tapering discussions later in the year. Strong labour and wage data, combined with large increases in commodity prices, highlight the risk of inflation to the upside. However, significant slack in the labour markets is expected to contain inflation risk. Markets performed solidly on the back of the strong economic data and confidence that the Fed will act accordingly to contain inflation.

Elections held in some Latin American countries caused market volatilities, such as Chile and Mexico.

Portfolio Performance

On a regional basis, Asia Pacific was the top contributor to quarterly performance (+2.72%), of which Philippines-based port operator International Container Terminal Services (+1.35%), Chinese gas utility ENN Energy (+0.89%) and Indian rail operator Container Corporation (+0.78%) were the lead performers.

ICTS operates terminals through long-term concession agreements with local port authorities and governments. Shares rose on the back of strong first-quarter operational and financial results, which were underpinned by strong volume recovery.

ENN Energy is one of the major listed gas distribution utilities in China, with a nationwide portfolio of last-mile city gas concessions and the longest operating track record among the listed players. Gas volume growth momentum in the first few months of 2021 has been stronger than market expectation, benefiting ENN Energy.

Container Corporation of India is India's largest container train operator, with 75% market share. Shares rallied with the resolution of land license issues with the Railways Ministry, and focus remains on privatisation.

Elsewhere in the region, Indian energy infrastructure company Gujarat Gas (+0.74%) also performed well during the quarter.

Gujarat Gas Limited is a city gas distribution business. It is one of India's leading natural gas distribution companies, processing and distributing compressed natural gas and liquefied petroleum gas to transport, domestic, commercial and industrial consumers. Industrial gas volumes are experiencing structural growth in India as the country moves from polluting fuels to cleaner gas fuels driven by regulatory bans and cheaper economics. FY21 earning results announced in June beat expectations on margins. The new COVID-19 wave and lockdown restrictions had more limited impact on industrial consumption of gases than compressed natural gas and piped natural gas.

Chinese gas utility China Gas Holdings (-1.23%) was the largest detractor from quarterly performance.

China Gas Holdings is the largest gas distribution utility in China, with a portfolio of last-mile city gas concessions. As the most ambitious early mover to tap into rural coal-to-gas opportunities, China Gas Holdings is well-positioned to achieve stronger-than-peers volume and earnings growth. Shares weakened due to an unexpected placement in April and a gas explosion at one of its city gas projects in June. Nonetheless, we believe shares have over-reacted, as the explosion was one-off, out of its 642 projects, and its gas volume growth guidance remains reassuring.

All returns are in local currency.

Positioning and Outlook

This Strategy is invested in high-quality companies benefiting from structural drivers, with strong cash flow and dividend yields. We have strong conviction in the long-term opportunities within emerging markets listed infrastructure. At the regional level, the Strategy is split between Asia Pacific EM (68%) and Latin America (29%), with the remainder in cash. At the sector level, the Strategy is split between economically sensitive user pays infrastructure (61%) and regulated and contracted utilities (36%).

For the **Global Infrastructure Emerging Markets Strategy**, the primary quantitative tool in portfolio construction is Excess Return, on which our stock-ranking system is based. As such, driven by valuation, the Investment Committee initiated positions in Chinese renewable utility China Longyuan Power Group and Chinese port operator Shanghai International Port Group.

The strategy also used the opportunity to crystallise some gains by exiting Thai electric utilities Ratch Group and Electricity Generating Public Company as well as Chilean water company Aguas Andinas.

Quarterly Stock Highlight

This quarter we review Chinese renewables utility Xinyi Energy Holdings.

Xinyi Energy was spun off in 2019 from Xinyi Solar, a solar glass manufacturer, and is a solar farm operator in China. It acquires solar projects from the parent based on a formula and bears no construction risks. The projects are mainly in the Anhui, Hubei and Tianjin provinces.

The solar projects that Xinyi Energy manages and operates sell electricity to the provincial grid on tariffs set by the government over the project lifetime. Xinyi Energy targets project IRRs of high single-digits. Solar energy, together with other renewable power generation, benefit from conducive regulations such as priority dispatch and mandatory full purchase by the power grid, as stipulated by the Renewable Energy Law, such that utilisation rate is relatively stable.

As a Chinese renewable YieldCo with a strong balance sheet, Xinyi Energy should achieve robust solar capacity CAGR of over 20% in coming years, mostly through dropdowns from Xinyi Solar, in our view. This should in turn drive distributable income and dividend growth based on an over 90% payout. We believe Xinyi Energy is highly leveraged to China's 2060 target of achieving carbon neutrality and the falling levelised cost of energy of solar farms. As it focuses on quality subsidy-free grid-parity solar projects, it is less vulnerable to subsidy-related risks such as payment delays or reduction, commonly faced by industry peers in China.

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